Part II Law of Corporate Governance in India: II. Legal Reform of Corporate Governance in India

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Rule of Law

Legal rights of shareholders and creditors to receive certain cash flows and to participate in various corporate decision-making activities, though necessary but are not sufficient conditions for effective corporate governance. A climate of respect for the rule of law is also needed. Thus, a core set of shareholder and creditor rights and an established tradition of legal enforcement of these rights are complementary features of an effective system of corporate governance. The following five enforcements variables define the rule of a law in a country, in addition to the quality of accounting standards:

1. The efficiency of the judicial system
2. An assessment of the law and order tradition
3. An index of government corruption
4. The risk of expropriation
5. The risk of reputation of a contract by the government

II. LEGAL REFORM OF CORPORATE GOVERNANCE IN INDIA

1. Corporate Governance: Problem in India

In India, the majority of companies, even the listed ones, are family controlled. The controlling shareholder is involved in management either directly or indirectly. The financial institutions, which hold shares for portfolio purposes, may provide a monitoring but not operational role, so they are not considered controlling shareholders. This concentrated ownership generates serious problems for minority shareholders and has a depressing effect on the economic growth. There are potential costs of minority shareholders in companies in which there is a controlling shareholder. The presence of a controlling position gives management an entrenched position. If decisions are made that do not benefit all shareholders and thus depress share price, the market for corporate control and the market for managers cannot operate to discipline poor managerial performance. If one goes by the principal-agent concept, the misalignment of interests of management and shareholders arises due to small ownership of managers. If there is professional management, the controlling shareholder monitors management carefully. Thus, with the increased holdings of equity, the alignment of interests of managers and shareholders improves and minority shareholders are not negatively impacted.

Given that there can be serious problems with concentrated holdings, can the corporate governance system be expected to solve these problems? Under the market-based system, the usual market solutions are not feasible due to size of managerial equity holdings. The board of directors may be concerned about shareholders, but they cannot be expected to be effective. However, a more diligent and independent board would help to resolve this problem. One potential solution is the equity market which, as a result of a lower share price for a poorly performing company, will provide discipline if the company intends to issue equity. The other disciplining factor is a competitive product market. With competition in the product market, decisions by controlling shareholder which do not maximize value, will ultimately lead to poor financial performance, financial distress and either bankruptcy, reorganization, or merger. This solution can take a long time but is assisted by pro-competitive policies within the economy including facilitating international competition in product and capital markets. Where markets forces do not work, there is a need for an effective corporate law to protect shareholders against oppression and a set of other minority shareholder protection provisions that can protect them. These protections include minority shareholder approval of important decisions in general meetings.

In the bank-based systems, just as in the market-based system, the solution is a competitive product market and its impact on the efficient operations of the companies. Aided by pro-competitive policies of the government in removing barriers and opening markets to internal and external competition, the product market can resolve many of the problems observed in closely held and family managed companies.

Financial Institutions may also become increasingly active in corporate governance and closely monitor corporate performance through effective use of their proxy or through informal discussions with board members or management. This may result in greater pressure on management to make operational and investment decisions that would increase the value of the shareholders’ wealth. Another influence of shareholder activism will be the performance of the overall stock market. If the stock market generates large returns, there is no shareholder activism. However, the long decline in the market forces shareholders to find ways to increase the share price of their companies. Poor equity performance also shakes the foundation for the cross-holdings of shares. Corporations would accept a low rate of return on their portfolio investment as a cross holding in exchange for long-term business returns.

In this scenario, the international institutional investors will also be important as they can have significant impact on the company's operations and decision-making. Poor economic conditions also put pressure on governments to change regulations and on companies to alter their operations and structures.[8]

2. Legal History of Corporate Governance in India

Family owned business houses in India followed a particular style of governance, which suited their personal interests. The stakeholders considered them as acronyms of competence and trust. The meager holding of the families in their company's capital, non-transparency in company operation at various levels and matters and superficial show of professionalism on the board with no public disclosure did not bring any effective intervention by stakeholders in a protected economy till the seventies in India. Non-separation of ownership from the management generated corruption in business and resulted in denial of enhancement in the value to the stakeholders' investment.

Since 1988, the fundamental concern of corporate governance, however, has remained to ensure the means by which a company's managers are held accountable to capital providers for an efficient use of assets of the company. The last five years have, nevertheless, witnessed a proliferation of corporate governance guidelines, reports and codes designed to improve the transparency in company operations and focus on liability of directors and to hold them accountable. Although, the board of directors provide an important mechanism for holding management accountable, effective corporate governance still has to be supported by and is dependent on capital market for corporate control, securities regulation, company law, accounting and auditing standards, bankruptcy laws, stock exchange listing rules and judicial enforcements.

The Confederation of Indian Industry (CII),[9] in 1998, framed a Voluntary Code of Corporate Governance for listed companies and made a small beginning in corporate governance. The CII Code recommended that key information must be reported half yearly to shareholders. Listed companies should have audit committees, corporates to give a statement on value addition, and consolidation of accounts of subsidiary companies to be optional.

The Unit Trust of India, in 1999,[10] also formulated a self-governance code of corporate governance, and this was followed by the professional bodies like the Institute of Company Secretaries of India (ICSI) to focus the attention of the Indian corporate sector on the imperative need to evolve new norms of governance to ensure sustained development of Indian industries on healthy lines.

The Security and Exchange Board of India,[11] (SEBI) on 7 May 1999, constituted a Committee on Corporate Governance, with 18 members under the chairmanship of Shri Kumar Managalam Birla, to promote and raise the standards of corporate governance in respect of listed companies. This Committee, after a good deal of deliberations with industrial associations and professional bodies, submitted its report on 25 January 2000. The Committee's primary aim was to view corporate governance from the perspective of investors and shareholders and to prepare a code suited to Indian corporate environment.

The Committee recommended various new norms for corporate governance. SEBI accepted the recommendations and enforced them by requiring Stock Exchange to include clause 49 in the Standard Listing Agreement. This clause-49 was required to be implemented by all stock exchanges and adopted by all listed companies, within a time frame of three years commencing from the financial year 2000-2001.[12] The main recommendations of this Committee related to: (a) composition of the board of directors, including independent directors, (b) constitution of audit committee to look into the financial aspects of a company, (c) remuneration of directors, (d) director's report to include management discussion & analysis report, (e) better disclosure norms to the shareholders through annual report, etc.

The company law, 1956 was also amended by the Companies (Amendment) Act, 2000, which introduced many provisions relating to corporate governance like additional ground of disqualification of directors, setting up of audit committees, inclusion of director's responsibility statement in the director's report and the introduction of mandatory postal ballot for specified items of business in the general meeting. This was a novel feature in India.

Corporate governance was also introspected by an Advisory Group constituted by the Standing Committee on International Finance Standards and Codes of the Reserve Bank of India[13] under the Chairmanship of Dr. Y.V.Reddy, the then Deputy Governor, who later became Governor of the Reserve Bank of India. These efforts focused the attention of the corporate boards that they should manage the affairs of companies with better accountability to shareholders and achieve transparency of operations with disclosure of both financial and non-financial data through annual report and other periodical reports. As a result, annual report of listed Indian companies, now reflect in adequate measure the new norms of governance.

After the Enron debacle in 2001, which revealed a hand-in-glove relationship between the auditors and the corporate clients and various other scams in the United States, such as Worldcom, Qwest, Global Crossing, and the auditing lacunae that eventually led to the collapse of Andersen, led to the enactment of the stringent Sarbanes Oxley Act (SOX Act) in the United States in 2002. The Act brought with it fundamental changes in virtually every area of corporate governance – and particularly in auditor independence, corporate responsibility, enhanced financial disclosures, and severe penalties, both fines and imprisonment, for wilful default by managers and auditors. It is fair to predict that the SOX Act will do more to change the contours of board structure, auditing, financial reporting and corporate disclosure than any other previous law in the US history.

These factors and development in the United States led the Department of Company Affairs, Ministry of Finance, Government of India in August 2002, to appoint a High Level Committee popularly known as the Naresh Chandra Committee to examine various corporate governance issues and to recommend changes in the diverse areas involving the auditor-client relationships and the role of independent directors. The Committee submitted its Report on 23 December 2002 to the Government.

In its report, the Committee commented on existence of a poor structure and composition of the board of directors of Indian companies, scant fiduciary responsibility of directors, poor disclosures and transparency norms, and inadequate accounting and auditing standards. The Committee stressed the need for experts to go through the minutest details of transactions among the companies, banks, financial institutions, and capital markets etc. The Committee also observed that the performance of many companies with regard to corporate governance standards is far from satisfactory. On the auditor– company relationship, the Committee recommended that the proprietary of auditors rendering non-audit services is a complex area, which needs to be carefully dealt with. The recommendations of this Committee were more or less in line with the Rules framed by the SEC of USA in accordance with the provisions of the Sarbanes-Oxley Act 2002. If implemented, the Committee's recommendations will have far-reaching effects on corporate governance.

In the year 2002 SEBI also analyzed the statistics of compliance with clause 49 by listed companies. It felt that there was a need to look beyond the mere systems and procedures, if corporate governance was to be made effective in protecting the interests of investors. SEBI, therefore, constituted a committee under the chairmanship of N.R.Narayana Murthy, Chairman, Infosys Technologies Ltd. to review the corporate governance code by listed companies and issue revised clause 49 based on its recommendations. The Committee included representatives from the stock exchanges, chambers of commerce and industry, academicians, investor associations and professional bodies.

The Narayana Murthy Committee submitted its report on 8 February, 2003. On the basis of the recommendations of the Committee, SEBI revised clause 49 of the Listing Agreement, so as to promote and raise the standards of corporate governance.[14] In the meantime many of the recommendations of the Naresh Chandra Committee were enforced in the form of the Companies (Amendment) Bill of 2003, which was introduced in the Parliament on May 2003. The bill has been withdrawn and Cabinet has directed to re-examine its provisions in the light of several practical problems posed by the Industry in the implementation of the provisions of the bill especially as to Composition of Board of Directors with majority of independent director.

The government, earlier on, had a thinking that corporate excellence is a way ahead of corporate governance. So, the Department of Company Affairs (DCA) on May 15, 2000 appointed a Study Group under the chairmanship of Dr. P.L. Sanjeeva Reddy, Secretary DCA to suggest ways and means of achieving corporate excellence and to explore the possibility of putting in place an implementable system and also to develop a firm infrastructure.[15] This study group constituted a Task Force under the Chairmanship of S. Rajagopalan, former Chairman, MTNL. This Task Force inter-acted with the delegates of Commonwealth Secretariat on Centre for Corporate Governance, various chambers of commerce and the professional bodies. The key recommendations of the study group were:

(i) Setting up an independent autonomous 'centre for corporate excellence', with a view to accord accreditation to promote policy research and studies, training and education awards, etc. In the field of corporate excellence, through improved corporate governance.

(ii) Introducing measures for greater shareholders' participation, through multiple location meetings, and electronic media, etc.

(iii) Introducing recognition of corporate social responsibility with Triple-bottom Line Accounting and Reporting.

(iv) Clearer distinction between direction and management to ensure that executive directors are held responsible for legal and other compliance with non-executive directors being charged with strategic and overall responsibilities.

(v) Highlighting directors' commitment and accountability through fewer and more focused board and committee membership, tighter independence criteria and minimization of interest-conflict potential.

(vi) Suggesting application of corporate governance principles to public sector undertakings both in the listed and even unlisted companies and upgrading their board with independent directors.

Corporate Governance *sine-qua-non* for Corporate Success:

Before going into details of the analysis of the different committees, it is necessary to look at some of the observations, which support the view that corporate governance is a *sine qua non* for corporate success. In the Foreword to the Report of the Rahul Bajaj Committee on Corporate Governance in India, (CII Report, 1998) Shekar Datta, the then President, Confederation of Indian Industry (CII) said that:

> "Corporate Governance is a phrase which implies transparency of management systems in business and industry, be it private sector, public sector or the financial institutions. Just as industry seeks transparency in government policies and procedures, so also, the debate on corporate governance seeks transparency in the corporate sector."

The Committee, which recommended the "Desirable Corporate Governance Code", also stated that "there is a global consensus about the objective of "good corporate governance: maximizing long-term share holder value."

Shri Narayana Murthy in his Report observed that:

> "Corporate governance is beyond the realm of law. It stems from the culture and mindset of the management and cannot be regulated by legislation alone. Corporate governance means the conducting the affairs of a company in such a way that there is fairness to all stakeholders and its actions benefits the greatest number of stakeholders. It is all about openness, integrity and accountability."

He also stated that:

> "Corporate governance is the key element in improving the economic efficiency of a company and makes the Board accountable to shareholders. The failure to implement corporate governance can have a heavy cost beyond regulatory problems. Companies that do not employ good governance can pay a significant risk premium when competing for scarce capital in the public markets. The credibility offered by corporate governance also helps to maintain the confidence of both the foreign and domestic investors, which helps in attracting more patient long term capital and also will reduce the cost of capital."

Corporate governance, thus, denotes the process, structure and relationship through which the Board of Directors oversees what the management does. It is also about being answerable to different stakeholders.

3. Status of Corporate Governance and Law Reform

Corporate Governance has been a buzzword in India since the year 1998. The introduction of clause 49 in the Listing Agreement on the basis of the Kumar Managalam Birla Committee Report, constituted in May 1999 by the SEBI have met with encouraging success, since most of the 'A' Group companies listed on BSE (Bombay

Stock Exchange) and NSE (National Stock Exchange) have complied with the norms recommended by the Committee. The recommendations, divided into mandatory and non-mandatory compliance, have been made applicable to all listed companies, their directors, management, employees and professionals associated with these companies.

However, the corporate governance has remained more on paper is clear from the Report on Corporate Governance by the Advisory Group constituted by the Standing Committee on International Financial Standards and Codes of the Reserve Bank of India.[16] The following facts emerged from the Report:

(i) The predominant form of corporate governance in India is ‘insider model’ where promoters dominate governance in every possible way. Indian corporates which reflect the pure ‘outsider model’ are relatively small in number.

(ii) A distinguishing feature of the Indian Diaspora is the implicit acceptance that corporate entities belong to founding families.

(iii) The listing agreement, the main instrument, through which SEBI ensures implementation of corporate governance, is a weak instrument, as its penal provisions are not stringent. The maximum penalty a stock exchange can impose on any company that does not follow the corporate governance norms is suspension of trading in its shares. This penalty hurts the investor community more than the management of the company that violates the listing agreement.

(iv) Regional stock exchanges where a large number of companies are listed lack effective organization and skills to monitor effective compliance with corporate governance norms.

(v) A vast majority of companies that are not listed remain outside the purview of SEBI’s measures.

(vi) The financial institutions that have large shareholdings in most of the listed companies have been passive observers in the area of corporate governance and do not effectively exercise their rights as shareholders.

(vii) The autonomy of the boards of Public Sector Units (PSUs) and public sector banks has seriously eroded due to special legislative provisions or notifications, day to day interference by the concerned administrative ministries, undermining thereby the necessary degree of autonomy.

Besides the above discouraging facts, the securities scam of 2002 that followed the same *modus operandi* as the scam of 1992 exposed the hollowness of the surveillance and enforcement of the Companies Act and the Listing Agreement. It is interesting to point out here that corporate governance in the form of clause 49 was already introduced in the year 2000.

Recent events in Indian stock exchanges have also exposed the hollow ethics of many of the Indian corporates and revealed following malpractices and frauds:

(i) Rampant insider trading by the promoters in league with big market players.

(ii) Massive price rigging/ manipulation by the promoters in league with big market players prior to mergers and takeovers.

(iii) Gross misuse of bank funds for clandestine stock market operations.

(iv) Criminally motivated investment in violation of laid down norms.

(v) Many companies, which raised money from the capital market through public issues, have not paid any dividend for more than five years.

(vi) The total amount of money duped by the vanishing companies (companies vanished after collecting monies through the public offerings) is calculated to be Rs 668,610 millions;;

(vii) Non-performing assets of scheduled commercial banks amounted to Rs 585,540 millions as on 31 March 2003.

In addition small investors have lost their hard earned money in the stock markets for the following reasons:

(i) Lack of ethics, selfish conscience, and breach of trust on the part of the promoters.

(ii) Lack of adequate compliance mechanism, supervision, proper inspection, effective regulation and preventive action by regulators like Department of Company Affairs, Registrar of Companies, Board of Stock Exchanges as well as SEBI.

(iii) Lack of professional ethics on the part of professionals like Chartered Accountants, Company Secretaries etc, who are holding onerous positions in companies.

(iv) Inadequate powers of SEBI – the premier market regulator to punish the violators.

Thus, no matter that most of the companies may be fully complying with the corporate governance norms laid down by clause 49, but the spirit and good conscience on the part of the promoters to observe ethical practices remained only on paper. Moreover, clause 49 the case of listed companies, non-listed companies are out of its purview.

A number of proposals have been made to improve corporate governance. The various suggested reforms include strengthening the position of internal and outside auditors; allowing mergers and acquisitions approved by a panel; requiring more independent outside directors on boards; introducing the supervisory board or two-tier system; allowing banks to own greater equity in shares of the companies; enhanced disclosure through consolidated balance sheets and enforcement of accounting standards. However, one of the most important ways in which the management of a corporation may be monitored is by an effective enforcement of capital market discipline. It involves the possibility of outside shareholders being able to displace poorly performing management, even in companies, where management possesses a significant (though not controlling) share ownership. It shall also permit shareholders, whose collective voice is hard to mobilize, some control by exercising their right of exit. The only mechanism required to make the capital market discipline is liberalization of restrictions on mergers and acquisitions, along with the bankruptcy provisions be allowed to operate without any government interference. One important commitment by the government, however, is that it will discontinue directed lending and permit commercial banks and government financial institutions to be run by their boards in the interest of their shareholders rather than the government.

In India, the four clusters of legal arrangements have been developed to respond to corporate governance problems. These are securities market regulations, the fiduciary responsibilities of directors and officers, laws governing takeovers, and rules governing shareholder voice. The major laws, which govern the corporate sector, are:

> the Companies Act, 1956; the SEBI Act, 1992; the Securities Contracts (Regulation) Act, 1956; the Foreign Exchange Management Act, 1999 (FEMA); the Depositories Act, 1996; the Debt Recovery Act 1993; the Benami Transactions (Prohibition) Act, 1988; the Arbitration and Conciliation Act 1996; the Indian Penal Code, 1860; the Banking Regulation Act, 1949, the Indian Evidence Act, 1872; the Indian Telegraph Act, 1885; the Consumer Protection Act, 1986; the Competition Act, 2002; and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

The two most important laws that control the listed companies are the Securities Contracts (Regulation) Act, 1956 which regulate all new public offerings, dealings in stock market and the functioning of the stock exchanges in India and the Securities and Exchange Board of India Act, 1992 which created the Securities and Exchange Board of India (SEBI), giving it the authority to administer the Securities Contracts (Regulation) Act, and all the other regulation of securities.

The major purpose of all these laws is to require regular, accurate, and timely public disclosure of financial information by any company that issued publicly traded securities and to instill public confidence in the reliability and accuracy of information so reported. A new law called the Indian Competition Act, 2002 has been enacted to replace the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969. The objective of the new law is to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

The Companies Act, 1956, and the Listing Agreement

The opening up of the Indian economy and the necessity to have good corporate governance, made the government of India to take number of steps through suitable provisions in the Companies Act, 1956 and through the Listing Agreement. 'Listing' denotes registration of a security as officially approved for dealing or trading on the stock exchange. A public company has no obligation to have its shares listed on a stock exchange. But if a company intends to offer its shares or debentures to the public for subscription by the issue of a prospectus, it must, before issuing such prospectus, apply to recognized stock exchange for permission to have the shares or debentures intended to be so offered to the public to be dealt within the stock exchange in terms of section 73 of the Companies Act, 1956. Thus, section 73 of the Companies Act makes listing compulsory where a company makes a public issue of shares or debentures by prospectus. It may be noted that Securities Contracts (Regulation) Act, 1956 does not make the listing of securities compulsory.

The listing agreement is required to be complied by only listed companies with stock exchanges in which the concerned company's shares are listed. While the requirements in relation to corporate governance set out in the Companies Act apply to all companies and the Department of Company Affairs, Government of India administers the Companies Act, the listing agreement applied to listed companies, is administered by stock exchanges under the supervision of SEBI, i.e., under the Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992. The requirements in the listing agreement have been inserted through the directives issued by the SEBI to which the Ministry of Finance has delegated powers. A numbers of requirements under the Companies Act and in the listing agreement are uniform, but on some major issues, which include the composition of the board, they vary. This obviously creates practical problems for listed companies.[17]

The regulation of the Indian capital market and listed companies began in 1992 with an impressive corpus of regulatory law being laid out. SEBI was statutorily empowered to regulate market intermediaries so as to better protect the integrity of transactions and thereby create investor confidence. SEBI's powers were further reinforced by transferring to it virtually all-substantive powers earlier vested in the Finance Ministry of the Government.

SEBI acts as a supervisor of the system undertaking supervision of the activities of various market participants. SEBI has put a modern regulatory framework with rules and regulations governing the behaviour of major market participants such as stock exchanges, brokers, merchant bankers, and mutual funds. It also regulates activities such as takeovers and insider trading which have implications for investor protection. SEBI liberalized the regulation of new issues, including allowing book building. It also increased information requirements for listed shares. The governing structure of stock exchanges has also been modified to make the boards of exchanges more broad based and less dominated by brokers.

4. Recommendations of Naresh Chandra Committee on Corporate Audit and Governance

On 21 August 2002, the Department of Company Affairs, Ministry of Finance and Company Affairs appointed a High Level Committee under the Chairmanship of Naresh Chandra to examine various corporate governance issues. Among others, this Committee was entrusted to analyse and recommend changes, if necessary, in diverse areas such as:

(i) the statutory auditor-company relationship to further strengthen the professional nature of this interface;

(ii) the need, if any, for rotation of statutory audit firms or partners;

(iii) the procedure for appointment of auditors and determination of audit fees;

(iv) restrictions, if necessary on non-audit fees;

(v) independence of auditing functions;

(vi) measures required to ensure that the management and companies actually present ‘true and fair’ statement of the financial affairs of the companies;

(vii) the need to consider measures such as certification of accounts and financial statements by management and directors;

(viii) the necessity of having a transparent system of random scrutiny of audited accounts;

(ix) adequacy of regulation of chartered accountants, company secretaries and other similar statutory oversight functionaries;

(x) advantages, if any, of setting up an independent regulator similar to the Public Company Accounting Oversight board in the Sarbanes – Oxley (SOX) Act of United States, and if so, its constitution; and

(xi) the role of independent directors and how their independence and effectiveness can be ensured.

The Committee, in its report, recognized that while the listed companies in India are required to follow very stringent guidelines on corporate governance, there is a wide gap between prescription and practice. The committee's recommendations were greatly influenced by the SOX Act of the United States. The Committee after having good deliberations with chambers of commerce and professional bodies, made significant recommendations for changes in the Companies Act. Its recommendations were related to audit (recommendation 2) auditing the auditors (recommendation 3), independent directors (recommendation 4) and other miscellaneous recommendations, to make the SEBI more effective.

In line with the international best practices, the Committee, among others recommended the following disqualifications for audit assignments (Recommendation 2.1):

(i) Prohibition of any direct financial interest in the audit client by the audit firm, its partners or members of the engagement team as well as their 'direct relatives';

(ii) Prohibition of receiving any loan and/or guarantee from or on behalf of the audit client;

(iii) Prohibition of any business relationship with the audit client;

(iv) Prohibition of any personal relationship;

(v) Prohibition of service during the cooling off period of two years for both the audit firm as well as audit client;

(vi) Prohibition of fee restriction. Fee should not exceed 25% of the total revenue from single client and its subsidiaries and affiliates.

In addition, an audit firm shall **not** provide the following non-audit services to an audit client (recommendation 2.2):

(i) Accounting and book keeping services;

(ii) Internal audit services;

(iii) Financial information system design and its implementation, including services related to IT systems for preparing financial or management accounts;

(iv) Actuarial services;

(v) Broker, dealer, investment adviser or investment banking services;

(vi) Outsourced financial services;

(vii) Management functions, including provision of temporary staff;

(viii) Valuation services and fairness opinion;

(ix) Any other services, other than audit and above-mentioned prohibited services, should be done only with the approval of the audit committee.

Auditor disclosure of contingent liabilities (recommendation 2.5): Management should provide a clear description of each material liability and its risks followed by the auditors comments on the management view. It should be highlighted in the significant accounting policies and noted on accounts as well as in the auditor’s report, if necessary.

Auditor's disclosure of qualifications and consequent action (recommendation 2.6): Qualifications to accounts if any, must form a distinct section of the auditor's report to the shareholders. It is also mandatory for auditor to send a copy of qualified report to the Registrar of Companies, SEBI and the principal stock exchange along with a copy of letter sent to the management.

Management's certification in the event of auditor's replacement (recommendation 2.7):A special resolution will be required if an auditor who is eligible for re-appointment is replaced. The explanatory statement should disclose the reasons for such replacement that shall be verified by audit committee as 'true and fair'.

Auditors' Annual Certificate of independence (recommendation 2.8): Auditors, before agreeing to be appointed, must submit a certificate of independence to the Audit Committee or Board that they are independent and have arm's length relationship with the client company and they are not engaged in any non-audit services or are not otherwise disqualified.

Appointment of auditors (recommendation 2.9): The Audit committee should discuss the annual work programme, review the independence of the audit firm and recommend with reasons the appointment or re-appointment or removal of external auditor and annual audit remuneration.

CEO and CFO Certification of Annual Audited Accounts (recommendation 2.10): Chief executive officer and chief finance officer shall certify that,

(i) they have reviewed the balance sheet and profit and loss account and all its schedules and notes on accounts, the cash flow statement and the Directors' Report;

(ii) these statements do not contain any material untrue statement or omit any material fact nor do they contain statements that might be misleading;

(iii) these statements together represent a true and fair view of the financial and operational state of the company and are in compliance with the existing accounting standards and/or applicable laws and regulations;

(iv) they are responsible for establishing and maintaining internal controls which have been designed to ensure that all material information is periodically made known to them, and have evaluated the effectiveness of internal control systems of the company;

(v) they have disclosed to the auditors and the audit committee any deficiencies in the design or operation of internal controls; instances of significant fraud involving management or employees; significant changes in internal control and accounting policies during the year;

(vi) they will return to the company that part of any bonus or incentive or equity based compensation that was inflated on account of such errors as decided by the audit committee.

Auditing the Auditors (Recommendations from Chapter 3 of the Report): The Committee recommended that three independent Quality Review Boards (QRB) should be established, one each for the Institute of Chartered Accountants of India (ICAI), the Institute of Company Secretaries of India, (ICSI), and Institute of Cost and Work Accountants of India (ICWAI) to periodically examine and review the quality of audit, secretarial and cost accounting firms and pass judgement and comments on the quality and sufficiency of systems, infrastructure and practices.

Board Size and Independent Directors (Recommendation 4): The Committee emphasized on the independence of directors, who should act as the fiduciaries of shareholders and not of the management. The Committee recommended for the appointment of an independent director on the board of directors. Minimum size of the board should be seven out of which four should be independent directors of listed companies. The independent directors should not be less than 50% of the board.

Independent director has been defined as a non-executive director who does not have any pecuniary relationship or transactions with the company, or its promoters, or its senior management and its holding or subsidiary company. There are seven more negative covenants:

(i) He is not related to promoters or management;

(ii) He has not been an executive of the company in the last three years;

(iii) He is neither a partner nor an executive of the audit, internal audit, legal firm or any consulting firm associated with the company for the last three years;

(iv) He is not a significant supplier, vendor or customer of the company;

(v) He is not a shareholder of a company owning 2% or more voting shares;

(vi) He has not been any type of director of company for more than nine years;

(vii) He is not a nominee director.

The requirement of independent director is applicable to all public companies that have capital and free reserves of Rs.10 crores or turnover of Rs. 50 crores. However, it is not applicable to unlisted public companies, which have not more than 50 shareholders and are without any debt from public, banks and financial institutions or to unlisted subsidiaries of listed companies. According to current listing norms, institutional directors on the board of companies should be considered as independent whether the institution is an investing institution or a lending institution. The institutional directors have same rights, duties, and responsibilities as other members of the board and as prescribed by Companies Act and listing norms.

Board Meeting by Tele or Video conferencing (Recommendation 4.5): A director may participate in the board meeting by teleconference or videoconference, if it is not possible for him to be physically present. However, minutes of all such meetings should be signed and confirmed by the concerned director.

Constitution of Audit Committee (Recommendation 4.7): Audit Committees of all listed companies as well as unlisted public companies, with a paid-up share capital and free reserves of Rs. 100 million)10 crores) and above, or turnover of Rs. 500 million (50 crores) and above should consist exclusively of independent directors. The role and function of audit committee should be clearly laid down in an audit committee charter. The chairperson of the audit committee must certify the date and frequency of meetings, to what extent functions listed in the charter were discharged, task performed, committee's views on adequacy of internal control systems, perceptions of risks, why financial statements with qualifications accepted and recommended, whether the committee met with the statutory and internal auditors without the presence of management and whether such meetings revealed materially significant issues or risks.

Remuneration and Exemption of Non-executive (Independent) directors (Recommendations 4.9 and 4.10): The present provisions of stock options and one percent commission on net profits as remuneration to an independent director is found to be adequate by the Committee. It recommended that loss making companies should be permitted by the DCA to pay special fee to independent directors. Such directors should be exempted from criminal and civil liabilities relating to company.

Training of Independent Directors (Recommendation 4.11): Independent directors are required to attend one training course before assuming responsibilities as an independent director. However, during initial years, they may undergo training within one year of becoming director. An untrained director should be disqualified.

Corporate Serious Fraud Office: The Committee realized that the fraudsters are enemies of both the stakeholders that they cheat, and the corporate sector, which loses because the fraudsters scare away existing and potential investors. The Committee, therefore, suggested for setting up a Corporate Serious Fraud Office (CSFO) on the lines of the US corporate frauds task force, without taking away the powers of investigation and prosecution from existing agencies at this stage, in the DCA. The Corporate Serious Fraud Office should be constituted as a multi-disciplinary team, which will not only cover fraud, but also direct and supervise prosecutions under various economic legislations through appropriate agencies.

5. Analysis of the Recommendations of the Narayana Murthy Committee

This Committee on Corporate Audit and Governance was constituted by SEBI in 2002, to evaluate the adequacy of existing corporate governance practices and further improve these practices. The Committee was comprised of members from various walks of public and professional life. This included captains of industry, academicians, public accountants and people from financial press and from industry journals. The issues discussed by the Committee primarily related to audit committees, audit reports, independent directors, related parties, risk management, directorship and director compensation, codes of conduct and financial disclosures. The Committee submitted its report on 8 February 2003.

The Committee took note of the recommendations of the Naresh Chandra Committee and based on that made mandatory and non-mandatory recommendations. The key mandatory recommendations focus on strengthening the responsibilities of audit committees; improving the quality of financial disclosures, including those related to party transactions and disclosure of use proceeds from initial public offerings; requiring corporate executive boards to assess and disclose business risks in the annual reports of companies; introducing responsibilities on boards to adopt formal codes of conduct; the position of nominee directors; and stockholder approval and improved disclosures relating to compensation paid to non-executive directors.

Non-mandatory recommendations included moving to a regime where corporate financial statements are not qualified; instituting a system of training of board members; and the evaluation of performance of board members.

The Committee believed that it was necessary to codify certain standards of good governance into specific requirements, since certain corporate responsibilities are too important to be left to loose concepts of fiduciary responsibility. When implemented through SEBI's regulatory framework, they will strengthen existing governance practices and also provide a strong incentive to avoid corporate failures. The Committee felt that the regulator should clearly define regulations and be able to effectively enforce the recommendations. The regulations should be as few as possible and the role of the regulator should primarily be that of a catalyst in enforcement. The mandatory recommendations of the Committee are:

Composition of the Board of Directors: The Committee recommended that board should have an optimum combination of executive and non-executive directors with not less than fifty percent of the board comprising the non-executive directors. In case a company has a non-executive chairman, at least one-third of board should comprise of independent directors, and in case a company has an executive chairman, at least half of the board should be independent. The nominee directors should have the same responsibilities and be subject to same discipline and be accountable to shareholders as any other director of the company.

Constitution and Functions of Audit Committee: A qualified and independent audit committee should be set-up by the board to enhance the credibility of the financial disclosures and promoting transparency. Members of audit committee should be '*financially literate*' (ability to read and understand basic financial statements) and at least one member should have '*accounting or related financial management expertise*', i.e., he must have requisite professional qualification or experience and background in finance or accounting or have been CEO, CFO or other senior officer with financial responsibilities. Audit Committee of public listed companies should review the following information mandatorily:

(i) Financial statements and draft audit report including quarterly/ half-yearly financial information;

(ii) Management discussion and analysis of financial condition and results of operations;

(iii) Reports relating to compliance with laws and risk management;

(iv) Management letters/ letters of internal control weaknesses issued by statutory/internal auditors;

(v) Records of related party transactions;

(vi) The appointment, removal and terms of remuneration of the chief internal auditor.

Disclosure of Accounting treatment and Audit Qualifications: If a company has followed a different treatment than the one prescribed in an accounting standard, independent/statutory auditors should justify why they believe such alternative treatment is more representative of the underlying business transaction. Management should also clearly explain the alternative accounting treatment in the footnotes to the financial statements. Companies should be encouraged to move towards a regime of unqualified financial statements. SEBI and stock exchanges should give a reasonable time to the company to acquire the necessary qualifications.

Related Party Transactions: The Committee noted that a statement disclosing the basis/methodology for various types of transactions entered into with related parties should be prepared and submitted for the information of the audit committee. It also opined that this statement should include transactions which are not on an arm's length principle. The company's management should explain to the audit committee the reasons for the non-arm's length nature of the transaction. The Committee recommended that a statement of all transactions with related parties including their bases should be placed before the independent audit committee for approval/ ratification; and if any transaction is not on arm's length basis then management should provide an explanation to the audit committee justifying the same. The term '*related party*' has the same meaning as contained in Accounting Standard 18, Related Party Transactions, issued by the ICAI.

Disclosure of Risk management to Board: As it is important for corporate board to be fully aware of the risks facing the business and also for shareholders to know about the process by which the companies manage their business risks, the committee, therefore, recommended that procedures should be in place to inform board members about the risk assessment and minimization procedures. These procedures should be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework. Management should place a report before the board in each quarter, documenting the business risks faced by the company, measures taken to address and minimize such risks, and any limitations to the risk taking capacity of the company. The board should formally approve this document.

Use of the Proceeds of IPO: Companies raising money through an Initial Public Offerings (IPOs) should disclose to the audit committee the use/ application of funds by capital expenditure, sales and marketing, working capital, etc. on a quarterly basis. On an annual basis, the company should prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus. The independent auditors should certify this statement. The audit committee should make appropriate recommendations to the board to take steps in this matter. The Committee noted that disclosure of unspecified uses of IPO proceeds would be a more transparent measure.

Written Code of Conduct for the Board and Executive management: The Committee taking note that the Kumar Manglam Birla Committee Report had defined the broad roles and responsibilities of management, recommended that it is obligatory for board to lay down the code of conduct for all board members and senior management of the company and not just for senior financial personnel. This code of conduct is to be posted on the company's website. Board members and senior management personnel should affirm compliance with the code on an annual basis. The annual report of the company shall contain a declaration to this effect signed by the CEO and COO. The Committee also recommended for the training of board members in learning. The business model as well as the risk profile of the business parameters of their company.

Restriction on Nominee Directors: The Committee recommended that there shall be no nominee directors. Where an institution or the government wishes to appoint nominee director on the board, such appointment should be made by the shareholders. Such nominee directors shall have the same responsibilities and liabilities as any other director.

Definition, Qualification and Compensation of Independent and non-executive Directors: This Committee adopted the same definition as formulated by the Naresh Chandra Committee, however, without the condition of maximum term of nine years. Compensation payable to the directors must be fixed by the board and approved by the shareholders in the general meeting. Maximum limit should be set for stock options in any financial year and in aggregate. Compensation philosophy and statement of entitled compensation to the non-executive directors should be published in the annual report of the company, together with the details of shares held. Non-executive directors are required to disclose their stock holding (both own and held on beneficial basis) in the listed company in which they are proposed to be appointed, prior to their appointment. This disclosure should also accompany their notice of appointment.

Evaluation of the performance of non-executive directors: The peer group comprising the entire board, excluding the director being evaluated, should make the performance evaluation of non-executive directors. This peer group evaluation should be the mechanism to determine whether to extend/continue the terms of appointment of non-executive directors.

Whistle Blower Policy: An important and controversial recommendation of the committee is the whistle blower policy, i.e., personnel who observe any unethical or improper practice (not necessarily a violation of law) in the company should be able to approach the audit committee without informing their supervisors. Company shall take measures to ensure that this right of access is communicated to all employees through means of internal circulars, etc. The employment and other personnel policies of the company shall contain provisions protecting such 'whistle blowers' from unfair termination and other unfair prejudicial employment practices. Further, companies should annually affirm that they have not denied any personnel access to the audit committee and have provided protection to the whistle blowers. The whistle blower policy, however, does not provide any mechanism against the frivolous complaints.

Audit Committee of Subsidiary Companies: The Committee took the view to extend the requirements relating to non-executive/independent directors and audit committees to subsidiaries of listed companies. It recommended that the provisions relating to composition of the board of the holding company shall be applicable to subsidiary company. At least one independent director of the board of holding company shall be on the board of subsidiary company. The audit committee of the parent company shall also review the financial statements, particularly the investments made by the subsidiary company. The minutes of board meetings of the subsidiary company shall be placed for review at the board meeting of the parent company. The board's report of the parent company should state that they have also reviewed the affairs of the subsidiary company. The Committee also recommended that central government should amend the Companies Act, 1956 to exclude common directorships in holding and subsidiary companies, in computing the limits on directorship that an individual may hold.

Real time disclosures (Disclosure of critical business events): It was suggested that SEBI should issue rules relating to disclosure of certain transactions or events that may be of importance to investors such as a change in the control of the company; a company's acquisition/disposal of a significant amount of assets; bankruptcy; a change in the company's auditors; and the resignation of a director. However, the Committee noted that there are certain practical problems in ensuring timely disclosure, so it made no recommendation in this respect.

6. Emerging Trends from the Recommendation of both the Committees

The recommendations of both the Committees, the Naresh Chandra Committee and the Narayana Murthy Committee, shall have far reaching effects on the management of corporate organizations, the audit firms and norms of corporate governance. Based on these recommendations, some of the changes in Companies Act, 1956 are perceived:

(1) Re-classification of Public companies into three categories:

(i) Public company having a paid up share capital and free reserves of Rs 50 millions or more or a turnover of Rs 500 millions or more - such companies should have a minimum number of seven directors out of which majority should be independent.

(ii) Public companies having less share capital plus free reserves or turnover than the above mentioned;

(iii) Unlisted Public companies having no more than fifty shareholders.

(2) New disqualifications for independent director

The list of disqualifications is too long and also harsh. It would be difficult to find suitable independent directors. Furthermore, a person holding 2% or more shares in a company is disqualified. By virtue of his stake in a company, a director shall expect the company to prosper so that he may get a good return on his investment and he would like to contribute to this.

(3) More restrictions on Auditors:

In future, auditor's appointment shall be subject to the terms and conditions 'as may be prescribed', and the auditor shall give a written certificate that he fulfills the conditions. To assure auditor independence and to ensure arm's length distance between auditor and auditee company, certain disqualifications have been proposed. The fine of punishment for the auditor who is in default has been increased to three times of total remuneration or fifty thousands or whichever is more.

(4) Composition of the Board of Directors:

The composition of the board is important as it determines the ability of the board to collectively provide the leadership and ensures that no individual or group is able to dominate the board. In India, the board is a combination of executive directors, with their intimate knowledge of business, and of outside, non-executive directors, who can bring broader view to the company's activities, under the chairman who accepts the duties and responsibilities which the post entails. The executive directors are involved in the day-to-day management of companies; the non-executive directors bring external and wider perspective and independence to the decision-making. Till recently, it has been the practice of most of the companies to fill the board with representatives of the promoters of the company, and independent directors were also handpicked and thereby ceasing to be independent. This has undergone a change and increasingly the boards comprise of following group of directors – promoter directors, executive directors and non-executive directors. Some of them are independent.

The corporate legislation in India stipulates that the directors of companies should be natural persons and also stipulates the qualifications for appointment of a person as a director. The legislation further provides that a private limited company should have a minimum of two directors and a public limited company a minimum of three directors.

In regard to the composition of the board, Clause 49 of the Listing Agreement provides that "the Boards shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. The number of independent directors would depend whether the Chairman is executive or non-executive. In case of a non-executive chairman, at least one-third of the board should comprise of independent directors, and in case of an executive chairman, at least half of the board should comprise of independent directors". The expression 'independent director' here means directors who apart from receiving director's remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which, in the judgment of the board may affect independence of judgment of the director. Thus, composition of board is one of the tools of corporate governance.

(i) Who Appoint the Directors: Generally, shareholders of a company appoint the directors. However, section 255 of the Companies Act provides that 1/3 of the total number of directors could be those who are not liable to retire by rotation. Such directors include nominee directors, debenture directors, non-rotational directors appointed by board by virtue of powers under the Articles of the company. A director could be appointed and removed by an ordinary resolution. Thus, technically a group of persons controlling one share more than 50% of the shares could control the composition of the board for they will be in a position to get their nominees elected as directors whether they are executive, non-executive or independent. In order to ensure participation of all shareholders in the decision-making process in respect of important matters, the legislature has provided for the system of postal ballot. Likewise, in order to ensure effectively that all shades of opinion constituting the company are represented on board, company’s Articles should provide that the directors are elected by the principle of proportional representation as provided under section 265 of the Act.

(ii) Can Non-resident be appointed as Directors?: Under the Indian laws, the whole body of directors of a company could comprise of non-residents. Furthermore, the Companies Act does not stipulate that the board meetings of companies incorporated in India should be held only in India. Thus, directors may look after the business from abroad and board meeting could be held abroad. Thereby, the necessity of the directors of such companies coming to India could be minimized or absent.

Directors are deemed to be officers in default under certain situations and they are also liable to penal offences for omissions and commissions under various provisions of the Act and other laws of the country. Thus, if all the directors of a company are non-resident, then it would be difficult, if not impossible, for the law to reach them. Some countries stipulate that one or more directors of a company should be a resident of the country in which the company is incorporated.

Neither the Companies Act nor Clause 49 of the Listing Agreement dealing with corporate governance provides that a company must have a director resident in India. It is, therefore, necessary to provide in relation to the composition of the board that at least one director should ordinarily be resident in India. It is particularly so because of the opening up of the Indian economy wherein number of MNCs are incorporating new companies in India as subsidiaries or otherwise and may provide in their Articles that all directors could be non-residents.

(iii) Maximum Number of Directors: With regard to composition of the Board, the Companies Act fixes maximum number of directors to 12 which a company can have. If any company desires to have more then the maximum than it could do so only with the approval of the central government. The interference of the government for fixing the maximum is not understood. The corporate sector in India now consists of giant companies such as Reliance, Maruti, Indian Oil Corporation etc and MNCs are also entering, so the promoters, the management and shareholders should be given the freedom to fix the strength of the board. Certainly, while fixing the maximum number, they will take into account the business needs of the company and other related matters.

(iv) New Grounds of Disqualification of Directors:[18] Whenever a company fails to file the annual accounts and annual returns for a continuous three financial years; or fails to repay its deposits or interest thereon on due date; or fails to redeem its debentures on due date; or fails to pay declared dividend for continuous one year, then the persons who are directors on the last date of these defaults shall be disqualified. They shall also not be eligible for appointment as a director in any other public company for a period of five years. It shall be the duty of statutory auditor to report to the members whether any director is disqualified. He shall also furnish a certificate each year as to whether on the basis of examination of the books and records any director of the company is disqualified. The company shall also file a return with the Registrar of Companies (ROC) furnishing the names and addresses of such directors. If the company fails to file this return, the officers of the company shall be in default. The ROC shall place one copy of it in the document file for public inspection and shall forward other copy to the central government. The central government shall place these details on the web-site of the DCA.

(v) Board Committees: Board committees carry out most of the board functions. The important committees are nominating, remuneration and audit committees. These committees are composed of non-executive directors. The minimum size of an audit committee recommended in India is three members, another requirement is time required by audit committee members and the importance of written terms of reference.

(vi) Rise in directors sitting fee: The government has raised the sitting fee of the board directors of 27 Public Sector Undertaking (PSUs) banks from Rs 1000-5000 per sitting. This goes in line with the trend in the corporate sector where the non-executive directors are now recompensed through higher sitting fee, commissions and other fee.

(vii) Chairman and Managing Director – held by a single person: A sizeable number of Indian companies combine the role of chairman and managing director. In about 34% of the BSE 200 companies, a single person, commonly referred as the Chairman and Managing Director (CMD), holds these positions. If we consider the cases where the relatives held these two posts, then the percentage rises to a whooping 41%. Seventy-four percent of the government held companies had the CMD posts held by a single person. In the United States, 80% of its S&P 500 companies combine these roles; while in the UK 90% of its listed companies separate these roles.[19]

Studies have shown that a majority of corporate failures were predominantly a result of misuse of power by one or more individuals, occupying a position of trust, who apart from causing loss of large amounts of money have also committed illegal acts. One of the most accepted ways that could curb misuse is by assigning the roles of chairman and CEO to different individuals. The intention is to separate the responsibilities of a MD, who is involved in the day-to-day activities of the organization from that of a chairman, who would also be concerned about the stockholder's interest.

Post-Enron, the pattern in CEO holding office of Chairman in the US is also changing rapidly. According to CFO.com in 2003, over 27 shareholder resolutions have been moved to split the roles of a chairman and CEO, while in 2002 there were only 4 such instances. The following Table illustrates the position in India:

BSE 30 Chairman Companies and MD Bajaj Auto Rahul Bajaj
BHEL KG Ramachandran BSES Anil Ambani Cipla YK Hamied HCL Tech Shiv Nadar MTNL Narinder Sharma Nestle Carlo M V Donati Reliance Mukesh Ambani ZEE Subhash Chandra

(5) Mergers & Acquisitions:

Mergers and acquisitions (M&A) serve as a vital instrument of corporate governance to increase corporate efficiency. M&As provide the platform where corporate ethos, minority rights protection, cultural conditions, regulatory environment and other contentious issues are tested over times. The economic reforms have resulted in a radical change in the process of corporate control and other forms of restructuring.

Two particular circumstances discourage M&As in India, viz., (1) the financial institutions had a high stake in the equity and they do not encourage takeovers, (ii)the existence of restrictive provisions in the laws do not encourage takeovers. For example, sections 372 and 108 of the Companies Act put limit on the extent of equity purchasable by a company in other company and refusal to register transfer of shares by the board of target company for reasons “in the interest” of the company. Now, section 372A[20] has been inserted which has brought a sea change in the investment limit.

The regulatory bodies have amended the listing agreement and appropriate amendments to takeover code. According to takeover regulations, the raider has to inform the stock exchanges once his holdings cross five percent in a particular targeted company. Further, when holdings cross ten percent, the buyer has to make an offer to buy another twenty percent of the shares from the public.

Amended clause 40B of Takeover Code provides that the takeover offer shall be placed in the first instance before the board of directors of the offeree company and shall contain detailed information. The Code allows the board of directors to offer an independent view on the pricing. A company board can tell shareholders that the price offered is unattractive and not to accept the offer unless it is improved. It restrains the board of the offeree company from issuing any authorized but unissued shares or to sell and dispose off assets of substantial amount without approval of the general body. SEBI makes it mandatory for corporate raiders to divulge their source of funds; whether the funds have come from domestic or foreign sources. This is to ensure to track that who are behind such bids.

Under section 29(1) of the Competition Act, 2002, the Competition Commission of India (CCI) can issue a notice to the parties of a combination, which it considers to be anti-competitive. Under section 29(2), the CCI may require the parties to publish the details of the combination.

The year 2003 was also the beginning for Indian companies venturing abroad. The year saw a sudden spate of overseas acquisitions by Indian companies, now confident of their engineering and technological skills. Corporates had an estimated free cash flow of Rs.23, 000 crore as on March 31, 2003. This had been achieved by adopting discipline in capital expenditure, cost cutting, better working capital management and reducing debt level. In addition, the government restrictions on overseas acquisitions have been eased and at the same time foreign exchange is no longer a constraint. Thus, Indian companies have restructured significantly and have the necessary balance-sheet strength to under- take inorganic growth. However, according to the KPMG study, the total value of merger and acquisition deals in India had fallen by a whopping 42%. According to this study, the total M&A deals value for the year 2003 is $ 3.7 billion as compared to $ 6.5 billion in 2002. This is because there are still host of restrictions on acquisitions beyond prescribed limits by foreign or domestic investors in banking and insurance sectors.

(6) Disclosure Requirements:

Disclosure compensates for the absence of a body of knowledgeable shareholders able to sit on boards of directors or otherwise to act as proxies for shareholders generally. Disclosures by companies are not an end in themselves and can not be a substitute for corporate integrity, nevertheless, they are useful. Disclosure is highly regulated under securities laws. However, there is a room for voluntary disclosure beyond what is mandated by law. Disclosures from corporate India have been improving, egged on by regulations, guidelines, international laws and global practices. Indian companies and regulators have realized that better disclosures invariable lead to better value creation. Corporate announcement put on stock exchange websites proves that there is an improvement in disclosures, both in quantity and quality. Material developments about key decisions are reported within reasonable time periods to stock exchanges. Promoters buying and selling options, grants of options, changes in directors, limited review statements are some of the data now made available to investors.

Directors are required to disclose their own relevant interests, and to disclose company's financial performance in an annual periodical report to shareholders. It is the board's responsibility to disclose accurate information about the financial performance of the company, as well as, information about agenda items, prior to general meeting of shareholders.

Company law and SEBI regulations place heavy emphasis on financial reporting obligations of the board, as well as the board oversight of the audit function. This is because they are key to investor confidence and the integrity of markets. The key development in the year 2003 was making available consolidated accounts for all companies. This does away with the opacity that existed in the form of a web of subsidiaries and joint ventures, with little information on the impact of these on the health of the holding company. Unraveling inter-company transactions and the true picture of profitability is now possible, which is an invaluable tool for shareholders. Further, in annual reports, companies now disclose related party transactions that highlight whether there are material transactions by the company with either promoters or their group companies. Further, managements have to disclose that an alternative accounting treatment has been followed while preparing accounts, and also have to explain as to why that method was adopted by the company.

A series of changes will also be coming from March 2004 onwards. Listed public companies will have to institute a whistle blower policy that will encourage employees to disclose knowledge of management fraudulent activity in the company and board and they will be protected for such disclosures against discrimination or unfair termination. Another disclosure that takes it roots from Sarbanes-Oxley legislation of the US, is the CEO and CFO certification of accounts. Annual reports will feature a certificate from the CEO and CFO, in which they will affirm that financial statements do not contain any misleading statements, they comply with laws, the company has not committed illegal acts and that they have kept auditors aware of incidents of fraud. This shall put direct onus on the executives unlike the current annual reports, where directors take responsibility and the scope is not as wide.

(7) Employee Stock Option Scheme (ESOP) Norms:[21]

SEBI has proposed changes in revised guidelines for the employee's stock option and stock purchase scheme. These guidelines were made on June 30,2003. Companies are now allowed to obtain an "in principle' listing approval in advance from stock exchanges to minimize the time lag between the allotment of shares (on exercise of options) and consequent listing of shares. The companies can file statements regarding ESOPs, anytime after the grant of options and before vesting of options. The same statement could be filed with depositories like National Securities Depository. In an effort to provide stock exchanges greater control over the stock option schemes, additional disclosures are required, for example, the number of securities reserved for ESOP, the total number of securities issued on cumulative basis and balance securities yet to be issued. SEBI also asks merchant bankers to ensure that ESOP scheme adhere to norms and should certify the correctness of disclosures. However, SEBI's norms on preferential allotment would not be applicable to shares issued under ESOP and stock purchase plans.

(8) New System to Track Price Rigging On Stock Exchanges:

SEBI is taking the integrated surveillance system for alerts on share price rigging. The proposal is being pursued under the US Aid Programme. The surveillance system is being upgraded which will help the market watchdog to immediately identify market operators inducing unnatural share price movements. A similar system is in use at NYSE and Nasdaq. Under the proposal, the system will link the regulator and stock exchanges and enable it to capture data on transactions in both cash and derivative sections, providing SEBI with a platform to take pro-active action against potential market manipulators. The Joint Parliamentary Committee probing the stock market scam in its report in December 2002, mooted the proposal for the establishment of an integrated surveillance system.

(9) Participation of women in company's Board:

While Indian companies are loudly articulating the importance of women as consumers and decision-makers, the fact is that corridors of corporate power are still completely out of bound for women. The corporates, however, plead that appointment on board should based on the competence of a person and not on the basis of gender.

The CMIE (Center for Monitoring of Indian Economy)[22] data about Board Composition shows that out of 2,079 board positions in the 200 Bombay Stock Exchange listed companies, only 43 positions were filled by women, and after discounting multiple representations, there are 28 women who are directors on the boards of BSE 200 companies. Only 17% companies have any women on the board. This makes up that only two out of every 100 board members in India's top companies are women. The private sector lags far behind the public sector. Furthermore, almost all the women on boards are either from the public sector, or from the promoter's families.

The Reliance Group and the Tatas have just one woman on the board across all their Group companies. The Aditya Birla group, the Bajaj group, and the Lalbhai group have the most feminine representation on their boards - with 3 each. The Essar, Kirloskar, Mahindra & Mahindra, and Bombay Dyeing group have no representation of women.

The Naresh Chandra Committee Report recommended for the appointment of women directors on the company boards, but surprisingly the Companies (Amendment) Act 2002 did not incorporate any provision to this effect. The Companies Amendment Bill 2003 (now withdrawn) had proposed to increase the representation of women on the companies' boards.

(10) National Foundation for Corporate governance:

The Government approved the setting up of a National Foundation for Corporate Governance as part of the effort to sensitize corporate leaders on the importance of good corporate governance, self-regulation and directorial responsibilities. The foundation will provide a platform to deliberate issues relating to good corporate governance. It will also provide research, training standard and capacity building and related support in the field of corporate governance. The government will provide a one-time grant of Rs 10 crore while the CII (Confederation of Indian Industries) will chip in 3 crore and the ICAI, ICSI will contribute Rs 1 crore each.

(11) Revised Clause 49 of the Listing Agreement:

SEBI revised clause 49 of the Listing Agreement to introduce corporate governance in August 2003, but has now deferred its implementation.[23] Revised clause 49 shall apply to all listed companies in accordance with the schedule given in a phased manner. All requirements are mandatory except, those given in Annexure IC. Such companies are also required to submit a quarterly compliance report to the stock exchanges through their compliance officer or CEO. The stock exchanges shall ensure that all provisions of corporate governance have been complied. They shall set-up monitoring cell to monitor the compliance with the provisions of corporate governance. The cell shall obtain the quarterly report from the companies and submit a consolidated compliance report to SEBI. The recommended clause 49 is based on recommendations of Kumar Manglam Birla Committee and Narayana Murthy Committee has proposed certain changes. The amended clause 49 is being further modified by SEBI in light of suggestions received by the SEBI. The text of clause 49 is appended to this study at the end.